

# The Nationalized Banking System and Foreign Debt

## I. Introduction

### A. RECENT CHANGES TO BANKING AND FINANCIAL STRUCTURE OF MEXICO

The Mexican banking and financial structure has undergone significant legal changes in the past twelve years. A chronology of the most important changes places these developments in perspective.

In 1971 the Mexican Congress amended the tax laws in order to grant preferential tax treatment to prime foreign lending institutions registered with the Ministry of Finance and Public Credit (hereinafter the "Ministry of Finance").<sup>1</sup> The purpose of this amendment was to dissuade Mexican borrowers from negotiating with small foreign lenders and money brokers that were subject to very high withholding taxes on interest paid by their Mexican borrowers. As is customary in international banking practices, withholding taxes on interest earned by the lender are paid by the local borrowers. The withholding taxes applicable to institutions registered with the Ministry of Finance were assessed by the legislature at 10 percent, *vis-a-vis* the 42 percent tax bracket to which non-registered institutions were subjected.<sup>2</sup>

During 1972 the Ministry of Finance published a set of rules in the Federal Official Daily of Mexico (hereinafter the "Official Daily") determining the registration requirements for the enjoyment of the preferential tax treatment contemplated by the legislature's 1971 amendments.<sup>3</sup> Likewise, the

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<sup>1</sup>D.O. (*Diario Oficial*, [Federal Official Daily]), December 29, 1971.

<sup>2</sup>Article 31 Section Ie and Article 41 Section II of the Income Tax Law of Mexico, as amended.

<sup>3</sup>D.O., April 10, 1972.

Ministry of Finance published the rules for the establishment and operations of representative offices by foreign banks.<sup>4</sup> These institutions are the only outlets permitted by Mexican law for foreign lending operations in Mexico. Until such publication, representative offices had been operating by virtue of "gentlemen's agreements" executed by the principal officers of the corresponding lending institution and the Ministry of Finance.

Up to the end of 1973 and for many years prior thereto, the banking laws of Mexico contemplated the establishment and operation of branches by foreign banks. However, for decades no such authorizations were issued by the Ministry of Finance as a matter of policy and finally, in 1974, the legislature made the law consistent with such policy and amended the banking laws to preclude the establishment of branch operations by foreign banks.<sup>5</sup> At the same time, the provisions of law concerning establishment of foreign branches were substituted by an article granting to the Ministry of Finance discretionary powers to approve the establishment of representative offices by foreign banks.<sup>6</sup>

A number of important legislative changes occurred in 1976, including the publication of rules contemplating the establishment of multiple banking institutions licensed by the federal government to perform all types of banking services under one corporate roof.<sup>7</sup> At the end of the year, Mexico suffered a major devaluation of the Mexican peso—its first in over 20 years.

At the beginning of 1978, the legislature allowed the Ministry of Finance to issue multiple banking licenses. In this respect, it should be mentioned that Mexican banks were predicated on the principle of specialized banking. Amendments to the banking laws were made later in the year, which allowed foreign and domestic banks to establish branches for offshore operations in Mexico, subject to rules to be published by the Ministry of Finance. It is of interest to note that, notwithstanding the availability of this possibility, the international banking community chose not to apply for the establishment of such institutions in Mexico.

The new decade of the 1980s began with the Mexican Congress in 1981 amending the banking laws to convert financial leasing companies into quasi-banking corporations.<sup>8</sup> But perhaps the most important changes in the legal structure of the Mexican banking and financial systems occurred in 1982. These changes included: the publication of rules to establish branches for offshore operations by foreign and domestic banks<sup>9</sup> (although none have

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<sup>4</sup>D.O., April 11, 1972.

<sup>5</sup>D.O., January 3, 1974, amendments to Article 6 of the General Law of Credit Institutions and Auxiliary Organizations.

<sup>6</sup>*Id.*

<sup>7</sup>D.O., March 18, 1976.

<sup>8</sup>D.O., December 30, 1981.

<sup>9</sup>D.O., January 4, 1982.

materialized as of this date); a major devaluation of the Mexican peso;<sup>10</sup> the establishment of dual foreign exchange rates;<sup>11</sup> the nationalization of all but two of the private banking corporations;<sup>12</sup> the establishment of generalized foreign exchange controls;<sup>13</sup> the commencement of litigation challenging the constitutionality of the nationalization of the private banks;<sup>14</sup> the execution of an agreement with the International Monetary Fund; amendments to the Mexican Constitution establishing banking services as a public service not subject to licensing;<sup>15</sup> the Central Bank becoming a decentralized agency of the federal government;<sup>16</sup> a telex from the Mexican Minister of Finance to the international banking community establishing principles for the restructuring of the Mexican public debt;<sup>17</sup> the publication of a new decree relaxing foreign exchange controls;<sup>18</sup> a further devaluation of the Mexican peso;<sup>19</sup> the publication of a law regulating banking and credit as a public service;<sup>20</sup> and the commencement of a major restructuring of the Mexican public and private debt.

Nineteen eighty-three saw three major events affect the banking and financial structure of Mexico. First, in an effort to restructure the Mexican public debt, the international banking community formed a five-billion dollar syndication for the Mexican government.<sup>21</sup> Second, the federal government of Mexico established a mechanism to cover the foreign exchange risks of Mexican borrowers and importers.<sup>22</sup> Finally, the Ministry of Finance published the compensation rules to indemnify the shareholders of the recently nationalized Mexican banks.<sup>23</sup>

#### B. UNCERTAINTY OF THE LEGAL ORGANIZATION AND STRUCTURE OF THE NATIONALIZED BANKING SYSTEM

The newly nationalized Mexican banking system has not yet been made subject to clearly defined rules delineating the philosophy that is to guide the institutions forming a part of that system. Although these institutions are to

<sup>10</sup>February 19, 1982.

<sup>11</sup>August 5, 1982.

<sup>12</sup>D.O., September 1 and 2, 1982.

<sup>13</sup>*Id.*

<sup>14</sup>Mid-September, 1982.

<sup>15</sup>D.O., November 17, 1982.

<sup>16</sup>D.O., November 29, 1982.

<sup>17</sup>December 8, 1982.

<sup>18</sup>D.O., December 13, 1982.

<sup>19</sup>December 20, 1982.

<sup>20</sup>D.O., December 31, 1982.

<sup>21</sup>March 3, 1983.

<sup>22</sup>The Trust for Coverage of Foreign Exchange Risks, known as "FICORCA," was established by Decree published in Federal Official Daily, March 11, 1983.

<sup>23</sup>D.O., July 4, 1983.

be changed from commercial corporations into "national credit associations", it is not clear how such institutions are to be legally structured.

## **II. Nationalization of Mexican Banks**

### **A. STATUS OF THE BANKING SYSTEM PRIOR TO NATIONALIZATION**

For a number of years, the Mexican banking system witnessed the co-existence of the so-called "multiple" banking licenses with "specialized" licenses allowing the undertaking of one or more "compatible" banking activities. For instance, it was possible for one banking institution to receive individual licenses from the federal government to undertake deposits, savings and trust operations. Private Mexican banks, whether "multiple" or "specialized," co-existed with (a) government-owned "national" credit institutions, which are agencies for the development of social priorities, such as construction, industrialization, and public banking; and (b) so-called "mixed" banks, which are private banking institutions in which a controlling interest is held by the federal government, participating in such institutions as a simple investor.

Under the legal system in effect prior to nationalization, all private banks existed under a license issued by the federal government pursuant to an Act of Congress entitled the "General Law of Credit Institutions and Auxiliary Organizations."<sup>24</sup> Private and public banking institutions were organized in Mexico as commercial stock corporations with limited liability. The availability of "multiple" banking licenses stimulated mergers that resulted in the formation of 35 "multiple" banks out of 127 merging institutions with various specialized banking licenses. This represented a major effort on the part of the Mexican government to decrease the number of banking institutions operating in the country. For many years, only one foreign branch had remained available for deposit banking under a grandfather clause; this is the branch currently operated by Citibank. Prior to the nationalization decree, the Mexican banking system consisted of eleven deposit banks, four investment banks, one mortgage company, five capitalization banks (a special type of savings institution), twenty-two "national" credit institutions, thirty-five "multiple" banks and four "mixed" banks.<sup>25</sup>

### **B. IMMEDIATE EFFECTS OF NATIONALIZATION**

Although the nationalization appears to have done away with the separate existence of the public and private banks, two private banks continue

<sup>24</sup>Originally published in D.O., May 31, 1941, as amended.

<sup>25</sup>Information conveyed to the author by officers of the Ministry of Finance and Public Credit of Mexico.

their operations under licenses from the Mexican government. These are the Banco Obrero (a "multiple" banking institution owned by the labor unions), and Citibank, N.A. which, as stated above, is the only branch in Mexico operated by a foreign bank authorized to undertake deposit banking. It is significant that "mixed" banks were expressly exempted from the nationalization decree and that in the nationalization decree the federal government chose to guarantee all obligations assumed by the recently nationalized banks. Subsequent to the nationalization decree, the Federal Constitution of Mexico was amended to: establish banking operations as a public service that would not be subject in the future to licensing in favor of private parties, and unionize bank employees. The later amendment had been strongly resisted in the past by private bankers, who considered unionization very dangerous to the stability of the Mexican economy.

Together with the amendments to the Federal Constitution of Mexico, Congress amended the Organic Law of the Central Bank, changing such bank from a commercial corporation into a decentralized agency of the federal government.<sup>26</sup> The federal government of Mexico formerly held 51 percent of the outstanding shares of the Central Bank corporation, with the remaining 49 percent held by the various private institutions operating as banking corporations under licenses granted by the federal government through the Ministry of Finance. Congress also issued a law which regulates banking and credit as a public service that in the future is to be rendered, on an exclusive basis, by "national credit associations," controlled predominantly by the federal government. These institutions may accept token private participation.

### C. PRESENT STATUS OF THE NATIONALIZED BANKING SYSTEM

Despite the nationalization efforts, Mexico continues to witness the co-existence of (a) private commercial corporations soon to be converted into "national credit associations," (b) national credit institutions of importance such as Nacional Financiera, S.A., Banco Nacional de Obras y Servicios Públicos, S.A. and Banco Nacional de Crédito Rural (statutory agencies for the development of social priorities), (c) mixed banks, soon to be converted into "national credit associations," and (d) private banking corporations such as Banco Obrero, S.A. and Citibank's branch. Also, the nationalization decree notwithstanding, Mexico continues to have banks that are enjoying specialized banking licenses to undertake limited banking activities or multiple banking.

At the present time, there is a certain obsolescence in the banking laws of Mexico. For example, it is no longer consistent for the federal government

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<sup>26</sup>See *supra* note 16.

to police or regulate a public service that is now being rendered by such government. To add to such inconsistency, nationalized banks now qualify as companies with government participation, and as such are subject to special regulations under Mexican administrative law.<sup>27</sup> Moreover, nationalized banks now have a confusing legal structure that is further complicated by the circumstance that the question concerning the constitutionality of the nationalization decree is still pending for decision by the Mexican courts.

### **III. Restructuring of Private and Public Debt**

The principles for the restructuring of the private debt were contained in a telex that the Mexican Minister of Finance addressed to the international banking community on December 8, 1982. Thereafter, the international banking community provided a five-billion U.S. dollar jumbo loan (signed on March 3, 1983), which was designed to support the Mexican government during the worst part of the financial crisis, and a number of credit lines from the major industrialized nations of the world were granted to the government in order to expedite foreign trade.

An important effort towards the restructuring of the Mexican public debt was made evident by an announcement issued on June 29, 1983 concerning the signing of an agreement between the governments of Mexico and fifteen industrialized nations, to restructure (with Mexican government support) the Mexican private external debt with guarantees furnished by foreign export credit corporations such as the Exim-Bank of the United States.

The standard draft of agreement for the restructuring of the external debt of all entities of the Mexican public sector provides for the guaranty of the United Mexican States, and for the signature of the Central Bank of Mexico, presumably for the purpose of assuring the availability of foreign exchange. A major feature of this standard form of agreement is a clause therein that provides for an exclusive choice of New York law. Based on past experience, there is a very high probability that the Mexican courts may reject such a provision.

Early signs of the troubles of the Mexican private sector were detected in 1982 when Grupo Industrial Alfa, one of the foremost conglomerates of Mexico, announced to its creditors that it was suspending payment of its obligations. This was a harbinger of difficult times to come. On August 4, 1982, an announcement of Alfa's restructuring plans preceded by just one day the establishment by the Mexican government of a dual exchange control rate, which represented the first time in modern Mexico that exchange controls had been imposed.

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<sup>27</sup>Article 3 Section II, and Articles 46 and 47 of the Organic Law of the Federal Public Administration.

Efforts to restructure the private debt have been subject to uncertainties with respect to the availability of collateral, conflicts of interest, especially as between foreign creditors, and many other problems. Conflicts of interest have also arisen as a result of the presence of a number of factors or circumstances that may affect the foreign creditors, such as the following: secured versus unsecured loans; individual versus syndicated lenders; litigation oriented versus settlement oriented philosophies; money-center banks versus regional banks; bank creditors versus supply creditors; Mexican banks versus foreign banks; feasibility of the Mexican borrower as a going concern; borrower's capacity to generate pesos or dollars; foreign exchange risks prompted by the possibility of future devaluations; flexibility of not-yet-tested governmental mechanisms to adapt to individual cases; bankruptcy or suspension of payments (counterpart of United States Chapter Eleven proceedings) of some major Mexican industrial groups; formation of a growing number of informal creditors' committees (steering committees) of many large Mexican borrowers; lenders of large industrial groups faced with individual companies' corporate veils; and unavailability of specialized Mexican counsel.

#### **IV. Conclusion**

It is obvious in the light of the foregoing that many problems remain in connection with Mexico's recent nationalization of private Mexican banks and satisfaction of Mexico's public and private foreign debt.

